This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 LAGOS 000099

SIPDIS

PARIS FOR OECD/IEA

E.O. 12958: N/A
TAGS: EPET ENRG EFIN ECON PINS NI
SUBJECT: Nigeria: Biweekly Energy Report No. 1

(This is the first in a series of biweekly reports on the energy sector in Nigeria. Information for these reports will be culled from open sources as well as contacts by the Mission with key players, official and commercial, in Nigeria's oil and gas-producing community.)

¶1. Summary. In late December, the Government of Nigeria (GON) released 24 billion Naira to its international oil joint venture partners in payment of arrears outstanding since the last era of military rule (1994-99). The deferral of payments had slowed investment by Nigeria's joint partners in the oil and gas sector in recent years. Seeking to increase local content, the GON is pressing for indigenous companies to account for at least 40 percent of human and material inputs in new projects, and is encouraging Nigerians to raise local content in the sector by funding areas where they have expertise. Gas flaring is down and use of natural gas is up. President Obasanjo announced a 2004 target for ending gas flaring, but some companies may be exempt from this deadline, at least temporarily. A fire at the Nigeria National Petroleum Company (NNPC) headquarters completely gutted the building the day before Christmas. Theories for the cause run from arson to cover up wrongdoing to another tragic accident. Septel will provide details. End summary.

Cash Calls

¶2. The longstanding delay that foreign oil companies had encountered in obtaining cash call payments for the period 1994-99 has been partially resolved, according to press reports. In late December, the NNPC reportedly made payments totaling 24 billion naira (about 185.0 million USD) to operators of joint ventures. Cash call payments defray the government's share of operating costs under joint venture arrangements in which the GON holds a 57 percent share. The arrears date back to military rule during the Abacha years.

¶3. While the arrears in nairas have been liquidated for 1994-1999, an industry source told us January 6 that the NNPC has not liquidated the foreign exchange component of the arrears outstanding for that period. There is disagreement over the amount owed. The foreign companies put the amount at 500 million USD while the government claims 300 million USD is owed. The deferral of the dollar payments has meant slower development of new fields. The naira component allows companies to make local purchases and pay local staff salaries. The U.S. currency permits companies to obtain needed services and supplies offshore.

¶4. Our source added that the cash call payment to his company last month meant that the payments that it received in 2002 were the largest in fifteen years. Our source said the NNPC is current in its naira and dollar cash call payments to the company going back to the year 2002. Some dollar arrears for the period before 2000 remain outstanding.

¶5. The delay in cash call payments had seriously restricted foreign oil companies' ability to expand production and had added extra costs to their operations. The companies had partly compensated by reducing the number of rigs operating, retiring staff prematurely or cutting back on the work force, merging departments, and dropping some employee perks. In the future, the issue of cash call arrears should be eliminated, as the GON shifts to Production Sharing Contracts (PSC's) as the means to develop hugely capital-intensive deep off-shore fields.

Indigenous Investment

¶6. The GON is encouraging Nigerian entrepreneurs to participate actively in the oil and gas industry. Toward this end, the GON wants to see the local content of current and future projects raised to at least 40 percent. Part of the problem facing start-up firms has been lack of capital. One of the ways of getting a foothold in the industry has been through purchase of existing fields with proven reserves. This usually has meant acquiring marginal fields or acquiring part or all of the GON's equity in a joint venture. Marginal fields are fields that foreign companies have abandoned because they appeared no longer to be commercially viable. The GON requires that marginal fields be set aside for indigenous companies with expertise in specific technical areas.

¶7. Another avenue of entry into the market for Nigerian entrepreneurs is through the provision of services to the oil and gas industry. However, most Nigerian firms do not have the financial ability to compete with the international firms that provide services to the industry. Few Nigerian firms can do this now because sophisticated technical skills and advance equipment are required. Most Nigerian entrepreneurs lease equipment at present. Nigerians are nonetheless hoping to find a niche through which to supply selected services to the industry.

¶8. Because Nigeria's primary source of revenue and means to "good" employment is the oil and gas industry, businessmen are learning about opportunities for partnerships, and entrepreneurs are emerging. Since Nigeria's focus in the coming years will be on offshore production of oil and gas, some Nigerian entrepreneurs may specialize in deep-sea diving services. Other Nigerian firms are considering arrangements for provision of leased drilling rigs to production companies. Some have opted to supply pipes for oil and gas lines. Other Nigerian firms want to produce drilling mud and associated chemical products. The challenge for these firms will be producing chemicals that conform to American Petroleum Institute standards.

Natural Gas Sector

¶9. President Obasanjo recently announced plans to end gas flaring by 2004 while he was attending the January 7 commissioning of an industrial gas project in Ogun State. The President conditioned his statement, saying "some of the oil companies might be exempted from the 2004 deadline." Technical Assistant to the NNPC Group Managing Director, Austen Oniwon tells us that most flaring will not end by ¶2004. Oniwon predicted the next significant reduction of flaring will occur when the LNG Trains 4 and 5 become operational in 2005 or 2006. (Note: About 50 percent associated gas is now flared compared to more than 70 percent in the mid-1990s.)

NNPC Fire

¶10. The Lagos office of the Nigerian National Petroleum Corporation (NNPC) was completely gutted by fire on December ¶24. The building, located on Ikoyi Island in Lagos, housed the offices of the Nigerian Petroleum Investment Management Services (NAPIMS), which is responsible for GON investments in the oil industry, and the Pipelines and Products Marketing Company (PPMC), whose mandate is marketing petroleum products. The leader of the Youth Democratic Movement (a previously unknown group) claimed responsibility for what is commonly believed to have been arson. Some of our industry sources have speculated that NNPC employees seeking to cover up details of long-term fraud within NNPC set the building on fire.

¶11. While the implications of the fire are being sorted out, it should be noted that joint ventures (JV) account for approximately 90 percent of Nigeria's oil production. NAPIMS supervises the JV operations so the destruction of NAPIM's records may have an adverse impact on oil production capacity, especially for new fields for which NAPIMS is presently processing contracts. The fire purportedly began on the eighth floor of the building, which housed NAPIMS, and later re-ignited on the second floor, where PPMC was located. Although the files of the GON's oil investments and joint venture activities are reportedly backed up at

NNPC's headquarters in the capital and at the international oil company offices, it remains to be seen how many of the NNPC records can be validly and reliably reconstituted.

Comment

¶12. The payment of cash calls to companies was long overdue. While the Obasanjo Administration has made efforts to pay legitimate debts incurred during military rule, the international oil companies still suffered when their cash call payments were held up. The NNPC's foreign partners have had to delay development of projects, shut down rigs, downsize and retrench in other ways to cut expenditures. Added to this has been the uncertainty of when payment in dollars will be made for the years prior to 1999 and in what amount. That said, the Obasanjo Administration has done a much better job in cleaning up cash call arrears than any contemporary Nigerian government.

¶13. Given that many indigenous companies will work marginal oil fields, we plan to address the political and economic importance of progress on these fields in septels. The GON, in its effort to encourage local content, may have to move cautiously since most indigenous companies lack funds and expertise.

¶14. We have reason to believe that the investigation of the NNPC fire is not being conducted in a serious manner and will never determine the cause of the blaze (see septel). We also do not know yet what the eventual cost of the NNPC inferno will be. In recent years, major suspicious fires consumed the Lagos offices of the Ministry of Defense and NITEL (Nigerian Telecommunications). With or without facts, the general assumption is that arson to cover up misdeeds was the cause and the investigation will flicker and eventually die out.

Hinson-Jones